

## Board Member Communication with Bond Rating Agencies

### Background

Santee Cooper finances approximately \$3.0 billion of its corporate debt through Revenue and Revenue obligation bonds. The cost of financing this debt is heavily impacted by ratings given by the three major bond rating agencies - Moody's, Standard and Poor's, and Fitch.

Historically, Santee Cooper's ratings have been both favorable and stable. [See historical (1977 - Present) chart attached]. Until December, 2004, all three rating agencies continued a nearly fifteen year trend of elevating and then holding the Company's rating to rating levels [AA2 (Moody's), AA-(S&P), and AA (Fitch)] granted only a small handful (less than 20%) of public power companies. In December, 2004, and April, 2005, Fitch and S&P, respectively, changed the "outlook" on their ratings to "negative." While this action did not result in a downgrade of the company's bond rating, it gave notice of the agencies' concerns over certain matters. (See reports attached).

Issue: Should individual Board members, without sanction or direction of the Board, communicate with bond rating agencies? Is such communication a breach of a director's duty of care owed to the company? If the communicating director seeks, through his communications, to negatively influence the company's rating or outlook, is such communication a breach?

### Materials Referenced:

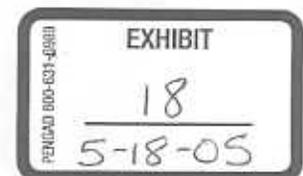
March 14, 2005 e-mail from Richard Coen to Guerry Green. Copied to Santee Cooper senior management and remaining Board members.

April 19, 2005 e-mail from Guerry Green to David Boder, Suzanne Smith and Demetri Nikas (analysts at S&P) forwarding Keith Munson's analysis of S. 573

- follows "formal" meeting at Wampee (one week prior).
- amends "formal" meeting characterization:
  - bill is worse than we described last Tuesday
  - will force shift in allegiance to customers
  - raises issue of co-ops forcing re-write of contract
  - invites input from analysts
  - "worried and concerned about future financial security of Santee Cooper"
- signs e-mail to analysts as Chairman of the Board of Directors

Munson e-mail of April 4, 2005 to Board members and key Santee Cooper management is attached.

- initiates "Lonnie" (Carter, CEO) to send to Wall Street
- analysis is presented on "Womble, Carlyle, Sandridge and Rice" letterhead



- raises issue of law firm's involvement
  - is analysis given as legal advice
    - roll of Board member providing such advice
  - offers legal assessment of effect on industry location decision (Gypsum/Drywall) contrary to that offered by Company's General Counsel
- Conclusions of Munson "analysis" include:
  - raises issue of a number of existing Board members resigning
  - surrender control to customers
  - predicts "this proposed legislation would probably cause Wall Street to panic"
  - Civil enforcement provisions are a "lottery"

# FitchRatings

## *Rating Action Commentary*

Contact:

Hiran Cantu +1-212-908-0371  
Karl Pfeil, III +1-212-908-0516

### **Fitch Rates Santee Cooper 2005 Series B Rev Obligations 'AA'**

Fitch Ratings-NY-January 20, 2005: Fitch rates South Carolina Public Service Authority (Santee Cooper) \$260 million revenue obligations, 2005 refunding series 'AA'. The Rating Outlook remains Negative (see below). In addition, Fitch affirms the following:

- \$8.7 million outstanding original bonds at 'AAA';
- \$763 million revenue bonds at 'AA';
- \$1.9 billion revenue obligations at 'AA';
- Commercial paper program at 'F1+'.

The 2005 B bonds are scheduled to price the week of Jan. 23, 2005 with Goldman, Sachs & Co. as senior manager. Bond proceeds will refund certain maturities of Santee Cooper's revenue bonds.

Fitch revised Santee Cooper's Rating Outlook to Negative from Stable on Dec. 17, 2004. The Negative Outlook reflects Fitch's concern over the continued turnover of Santee Cooper's board of directors and its long-term credit impact. Since 2000, 17 directors have not completed their terms as a result of resignation or removal from the board by the current and former governor. Fitch's public power rating places a significant weight on management and governance. Uncertainties about the experience and consistency of leadership with the board can have negative credit consequences. Fitch analysts will be speaking further with management and state leaders in the coming weeks to clarify the long-term implications of these governance issues. For additional information regarding the Rating

Outlook revision, see the press release dated Dec. 17, 2004, available on the Fitch Ratings web site at '[www.fitchratings.com](http://www.fitchratings.com)'.

The recent changes at the board level have not had an impact on Santee Cooper's financial and competitive profile. Santee Cooper is one of the largest and highest rated municipal electric utilities in the nation. Santee Cooper's credit rating is reflective of a strong financial profile, highly efficient and competitive power supply assets, steady energy sales growth, and experienced management. Santee Cooper's financial profile includes 2003 debt service coverage of 1.9 times (x). In addition, Santee Cooper's liquidity is approximately \$300 million (over four months of operating expenses). Un-audited results for fiscal 2004 are in line with historical levels. Further supporting Santee Cooper's liquidity is the automatic cost-adjustment mechanisms in most of Santee Cooper's customer contracts.

Other credit factors include Santee Cooper's debt structure, rising fuel costs, and continued coal delivery problems.

#### Debt Structure

In the past two years, Santee Cooper has financed new base load generation assets with long-term borrowing that have maturities beyond the 2023 expiration of Santee Cooper's contract with Central Electric Cooperative, Inc. (all the 2005 B bonds mature prior to the contract's expiration date). Central is a wholesale generation and transmission cooperative that constitutes approximately 50% of Santee Cooper's energy sales. Partially mitigating this concern are favorable contract terms and substantial incentives that exist for the two parties to maintain their relationship beyond the contract's expiration.

#### Fuel Costs

Santee Cooper's increasing fuel costs are primarily due to Santee Cooper's heavy reliance on coal from the Appalachian region and the expiration and termination of below market coal supply contracts. These changing fuel prices have had a large impact on Santee Cooper's average revenues from sales rising 17% since 2000.

#### Coal Delivery

Santee Cooper continues to receive insufficient delivery of coal. Santee Cooper currently derives 75% of its energy from coal-fueled generation (2,791 mw). Since early 2004, Santee Cooper's primary rail carrier, CSX, has had limited capacity to meet its requirements to many of its customers, including Santee Cooper. While this constraint has not affected Santee Cooper's use of its base load coal units, its current on-site supply (25 days) is well below historical Santee Cooper levels (above 60 days throughout most of the 1990s). Fitch first mentioned this concern in the summer of 2004. Management expects its supply will increase to the desired level of 40 days' supply by the second quarter of 2005.

Partially mitigating Santee Cooper's fuel-related credit issues is Santee Cooper's financial strength and rate flexibility mentioned above, retail and wholesale electric rates that are still regionally competitive, the lack of retail deregulation activity in South Carolina, and the expected long-term outlook for regional coal (especially relative to natural gas).

Santee Cooper sells electricity to wholesale and retail customers. Wholesale sales account for 53% of electric revenues with industrial and direct retail sales accounting for 27% and 20% of electric revenues. Santee Cooper serves directly or indirectly over one third of the state's population.

# Fitch Ratings

One State Street Plaza  
New York, NY 10004

T 212 908 0500 / 800 75 FITCH  
www.fitchratings.com

January 3, 2005

Mr. Rod Murchison  
Treasurer  
South Carolina Public Service Authority  
One Redwood Drive  
P.O. Box 2946101  
Moncks Corner, SC 29461-2901

Dear Mr. Murchison:

Fitch Ratings has assigned one or more ratings and/or otherwise taken rating action(s), as detailed on the attached Notice of Rating Action.

Ratings assigned by Fitch are based on documents and information provided to us by issuers, obligors, and/or their experts and agents, and are subject to receipt of the final closing documents. Fitch does not audit or verify the truth or accuracy of such information.

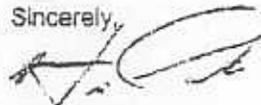
It is important that Fitch be provided with all information that may be material to its ratings so that they continue to accurately reflect the status of the rated issues. Ratings may be changed, withdrawn, suspended or placed on Rating Watch due to changes in, additions to or the inadequacy of information.

Ratings are not recommendations to buy, sell or hold securities. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect of any security.

The assignment of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement or other filing under U.S., U.K., or any other relevant securities laws.

We are pleased to have had the opportunity to be of service to you. If we can be of further assistance, please feel free to contact us at any time.

Sincerely,



Hiran Cantu

/ka

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(Doc ID: 3753)

## Notice of Rating Action

<u>Bond Description</u>	<u>Par Amount</u>	<u>Rating Type</u>	<u>Action</u>	<u>Rating</u>	<u>Outlook/ Watch</u>	<u>Eff Date</u>	<u>Notes</u>
South Carolina Public Service Authority (Santee Cooper) (SC) rev bonds		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev bonds rdg ser 1995B (insured: Financial Guaranty Insurance Company)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev bonds rdg ser 1996B (insured: Ambac Assurance Corp.)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev bonds rdg ser 1997A (insured: MBIA Insurance Corp.)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev bonds rdg ser 1998B (insured: MBIA Insurance Corp.)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev oblig bonds (taxable) ser 1998B (insured: MBIA Insurance Corp.)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev oblig bonds ser 1999A (insured: MBIA Insurance Corp.)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev oblig bonds ser 2002B (insured: Financial Security Assurance, Inc.)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev oblig bonds ser 2002C (insured: Financial Security Assurance, Inc.)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev oblig bonds ser 2004A		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev oblig rdg & improv bonds ser 2001A (insured: Financial Security Assurance, Inc.)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev oblig rdg bonds ser 2002A (insured: Financial Security Assurance, Inc.)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev oblig rdg bonds ser 2002D		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev oblig rdg bonds ser 2002D (insured: Financial Security Assurance, Inc.)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev obligs ser 2004M		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev obligs ser 2005A		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	

## Notice of Rating Action

<u>Bond Description</u>	<u>Par Amount</u>	<u>Rating Type</u>	<u>Action</u>	<u>Rating</u>	<u>Outlook/ Watch</u>	<u>Eff Date</u>	<u>Notes</u>
South Carolina Public Service Authority (Santee Cooper) (SC) rev rfdg obligs ser 2003A		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	
South Carolina Public Service Authority (Santee Cooper) (SC) rev rfdg obligs ser 2003A (insured; Ambac Assurance Corp.)		Long Term	Revision Outlook	AA	RO:Neg	17/Dec/2004	

Key: RO: Rating Outlook, RW: Rating Watch; Pos: Positive; Neg: Negative; Sta: Stable; Evo: Evolving

## Fitch Puts Negative Outlook On South Carolina's Santee Cooper

By Shelly Sigo

BRADENTON, Fla. — Fitch Ratings on Friday placed a negative outlook on its AA rating on \$3 billion of outstanding debt issued by the South Carolina Public Service Authority on behalf of Santee Cooper, one of the largest and highest-rated municipal electric utilities in the nation.

"This action relates to the recent removal of the chairman of Santee Cooper's board of directors, the resignation of another board member, and the reshuffling of the board of directors over the past four years," said a report by Fitch analyst Hiran Cantu.

Fitch has had increasing concern over the continued turnover of Santee Cooper's board of directors and its impact on the utility's long-term credit, according to Cantu, who wrote, "Governance issues of this nature are not typical for an AA-rated municipal electric utility."

On Dec. 10, Gov. Mark Sanford issued an executive order removing Thomas Edwards from the authority's board of directors and replacing him with Guerry Green. Sanford's order gave no reason for removing Edwards.

**"Governance issues of this nature are not typical for an AA-rated municipal electric utility," says Fitch's Hiran Cantu, citing turnover at Santee Cooper's board of directors.**

Fitch pointed out that Sanford is the second straight governor to "effectively" replace Santee Cooper's entire board upon taking office. Currently, the utility's Web site indicates that one position on the board remains vacant. John West, chief legal officer, is retiring Dec. 31 after 14 years.

While Santee Cooper has a strong service territory, solid financials, low rates, and good management, Fitch also said uncertainties about leadership consistency can have negative credit consequences.

The utility is rated Aa2 by Moody's Investors Service and AA-minus by Standard & Poor's.

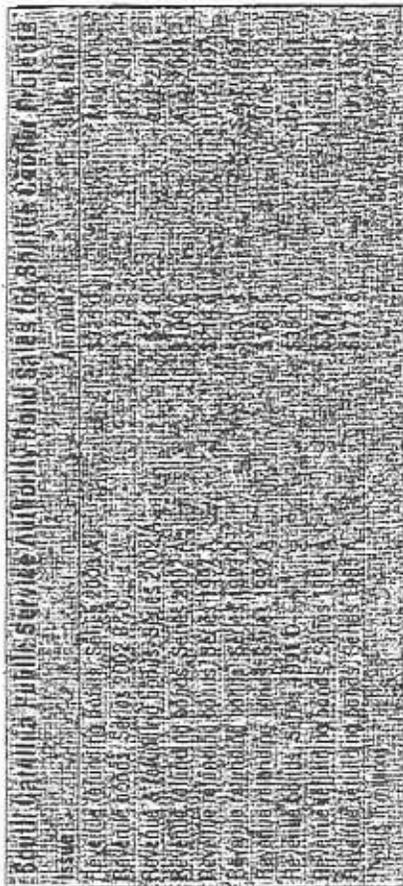
"The most important thing here is to focus on what we can control," said Laura Varru, spokeswoman for Santee Cooper. "Our leaders are focused on ... providing low-cost and reliable power and excellent customer service while operating in a safe environment."

Moody's analyst Dan Aschenbach said the agency views changes at Santee Cooper as fairly routine, especially when governors have the authority to appoint members.

"We do believe the boards, over the years, have shown confidence in the Santee Cooper management group, which has not changed," Aschenbach said. "The financial and operative results are evidence that the utility is still a strong and stable credit."

Santee Cooper is South Carolina's state-owned electric and water utility, serving 142,000 residential and commercial customers in Berkeley, Georgetown, and Horry counties. The utility also generates the power distributed by electric cooperatives serving another 625,000 customers in 46 counties.

The authority was created in 1934 to build and operate the Santee Cooper Hydroelectric and Navigation Project, between the Santee and Cooper rivers. □





Lonnie N. Carter  
President and  
Chief Executive Officer

One Riverwood Drive  
Moncks Corner, SC 29461-2901  
(843) 761-4132  
Fax: (843) 761-7037  
P.O. Box 2946101  
Moncks Corner, SC 29461-6101

May 11, 2005

**TRANSMITTAL BY FAX  
212-438-2154**

Mr. Dimitri Nikas  
Standard & Poor's Ratings Group  
55 Water Street, 38th Floor  
New York, NY 10041-0003

Re: Request of Michael N. Couick

Dear Dimitri:

This confirms the telephone conversation that you and I and Jim Brogden had concerning the request of Mike Couick that you release to him certain documents that Standard & Poor's received concerning Senate Bill S.573. Mr. Couick is Director of Research and Attorney to the South Carolina Senate Judiciary Committee. This information is being requested in connection with the confirmation hearings for Santee Cooper Board members which will be conducted the week of May 16<sup>th</sup>.

This letter authorizes Standard & Poor's to provide to Santee Cooper any and all e-mails and attachments from any Board member of Santee Cooper relating to S.573 and/or any summaries which Standard & Poor's may have received from any Board member about S.573.

Please provide these documents to us by fax. We will, in turn, forward the documents to Mr. Couick.

By copy of this letter to Mr. Couick, we are advising him that we have requested this information.

With kindest regards, I am

Very truly yours,

  
Lonnie N. Carter

LNC:kays

cc: Michael N. Couick (by fax - 803/212-6600)